DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 07-0220
Withholding Tax
For The Tax Years 2003

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Adjusted Gross Income Tax - Imposition.

Authority: 26 U.S.C.A. § 6031; IC § 6-8.1-5-1(c); IC § 6-3-2-1(a); IC § 6-3-4-10(a); IC § 6-8.1-5-2(a).

The Taxpayer protests the imposition of adjusted gross income tax.

II. Withholding Tax - Twenty-Percent Penalty.

Authority: IC § 6-3-2-2.8; IC § 6-3-4-13; IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; 45 IAC 15-11-2

The Taxpayer seeks abatement of the twenty-percent penalty for failure to file Form WH-1 and remit withholding tax on non-resident shareholders.

STATEMENT OF FACTS

The Taxpayer is an Illinois Sub Chapter S Corporation that provides soil stabilization services in several states including Indiana. A review of the Taxpayer's 2003 Indiana S Corporation return resulted in an assessment of additional adjusted gross income tax, interest, and penalty. The Taxpayer protested the assessment and penalty. A hearing was held and this Letter of Findings results.

I. Adjusted Gross Income Tax – Imposition.

DISCUSSION

The Department assessed adjusted gross income tax on the Taxpayer's portfolio income and gains from an investment in a Florida partnership pursuant to IC § 6-3-2-1(a). The

Taxpayer protested this assessment because it considered the income non-business income allocable to Illinois.

All assessments by the Department are presumed to be valid. IC § 6-8.1-5-1(c). The Taxpayer bears the burden of proving that any assessment is incorrect. *Id.*

Subchapter S Corporations are taxed like partnerships. IC § 6-3-4-10(a) requires that "partnerships and Subchapter S Corporations report income corresponding with the returns required by Section 6031 of the Internal Revenue Code[.]" 26 U.S.C.A. § 6031 requires that partnerships and Subchapter S Corporations report "gross income and the deductions allowable by subtitle A[.]" Subtitle A does not allow a deduction for portfolio income or gains from partnerships in another state.

The Taxpayer was required to report the total gross income on the Indiana return. Indiana law also does not provide a deduction for portfolio income or gains from an investment in an out of state partnership. Whether or not the income is business income is not germane to the discussion. Therefore, the Taxpayer incorrectly deducted the disputed income from its total income before applying the apportionment percentages to determine the amount of income subject to Indiana taxation.

The Taxpayer also protested the timing of the Department's notice of proposed assessment. The Taxpayer argued that the Department's timing of the notice of proposed assessment precluded it from amending its Illinois return. The Department issued the proposed assessment within the three year Indiana Statute of Limitations as required by IC § 6-8.1-5-2(a). The Department does not have a duty to issue an assessment within the time period that is necessary for a Taxpayer to amend its return in another state.

FINDING

The Taxpayer's protest is denied.

II. Withholding Tax - Twenty-Percent Penalty.

DISCUSSION

Taxpayer believes that it is entitled to abatement of the twenty-percent penalty for failure to file Form WH-1 and remit withholding tax on its non-resident shareholders.

The taxpayer argues that the penalty was unfairly assessed because the shareholders timely filed their Indiana non-resident income tax returns and remitted all taxes due. Further the taxpayer began Indiana nonresident withholding in 2006 after being notified of the 2003 issue.

Pursuant to IC § 6-3-2-2.8:

Notwithstanding any provision of IC 6-3-1 through IC 6-3-7, there shall be no tax on the adjusted gross income of the following:

(1) Any organization described in Section 501(a) of the Internal Revenue Code, except that any income of such organization which is subject to income tax under the Internal Revenue Code shall be subject to the tax under IC 6-3-1 through IC 6-3-7.

(2) Any corporation which is exempt from income tax under Section 1363 of the Internal Revenue Code and which complies with the requirements of IC 6-3-4-13. However, income of a corporation described under this subdivision that is subject to income tax under the Internal Revenue Code is subject to the tax under IC 6-3-1 through IC 6-3-7. A corporation will not lose its exemption under this section because it fails to comply with IC 6-3-4-13 but it will be subject to the penalties provided by IC 6-8.1-10.

(3) Banks and trust companies, national banking associations, savings banks, building and loan associations, and savings and loan associations.

(4) Insurance companies subject to tax under IC 27-1-18-2, including a domestic insurance company that elects to be taxed under IC 27-1-18-2.

(5) International banking facilities (as defined in Regulation D of the Board of Governors of the Federal Reserve System (12 CFR 204)). (**Emphasis added**).

According to IC § 6-3-4-13:

(a) Every corporation which is exempt from tax under IC 6-3 pursuant to IC 6-3-2-2.8(2) shall, at the time that it pays or credits amounts to any of its nonresident shareholders as dividends or as their share of the corporation's undistributed taxable income, withhold the amount prescribed by the department. Such corporation so paying or crediting any nonresident shareholder:

(1) shall be liable to the state of Indiana for the payment of the tax required to be withheld under this section and shall not be liable to such shareholder for the amount withheld and paid over in compliance or intended compliance with this section; and

(2) when the aggregate amount due under IC 6-3 and IC 6-3.5 exceeds one hundred fifty dollars ($150) per quarter, then such corporation shall make return and payment to the department quarterly, on such dates and in such manner as the department shall prescribe, of the amount of tax which, under IC 6-3 and IC 6-3.5, it is required to withhold.

(b) Every corporation shall, at the time of each payment made by it to the department pursuant to this section, deliver to the department a return upon such form as shall be prescribed by the department showing the total amounts paid or credited to its nonresident shareholders, the amount withheld in accordance with the provisions of this section, and such other information as the department may require. Every corporation withholding as provided in this section shall furnish to its nonresident shareholders annually, but not later than the fifteenth day of the third month after the end of its taxable year, a record of the amount of tax withheld on behalf of such shareholders on forms to be prescribed by the department.

(c) All money withheld by a corporation, pursuant to this section, shall immediately upon being withheld be the money of the state of Indiana and every corporation which withholds any amount of money under the provisions of this section shall hold the same in trust for the state of Indiana and for payment thereof to the department in the manner and at the times provided in IC 6-3. Any corporation may be required to post a surety bond in such sum as the department shall determine to be appropriate to protect the state of Indiana with respect to money withheld pursuant to this section.

(d) The provisions of IC 6-8.1 relating to additions to tax in case of delinquency and penalties shall apply to corporations subject to the provisions of this section, and for these purposes any amount withheld, or required to be withheld and remitted to the department under this section, shall be considered to be the tax of the corporation, and with respect to such amount it shall be considered the taxpayer.

(e) Amounts withheld from payments or credits to a nonresident shareholder during any taxable year of the corporation in accordance with the provisions of this section shall be considered to be a part payment of the tax imposed on such nonresident shareholder for his taxable year within or with which the corporation's taxable year ends. A return made by the corporation under subsection (b) shall be accepted by the department as evidence in favor of the nonresident shareholder of the amount so withheld from the shareholder's distributive share.

(f) This section shall in no way relieve any nonresident shareholder from the shareholder's obligation of filing a return or returns at the time required under IC 6-3 or IC 6-3.5, and any unpaid tax shall be paid at the time prescribed by section 5 of this chapter.

(g) Instead of the reporting periods required under subsection (a), the department may permit a corporation to file one (1) return and payment each year if the corporation pays or credits amounts to its nonresident shareholders only one (1) time each year. The withholding return and payment are due on or before the fifteenth day of the third month after the end of the taxable year of the corporation.

(h) If a distribution will be made with property other than money or a gain is realized without the payment of money, the corporation shall not release the property or credit the gain until it has funds sufficient to enable it to pay the tax required to be withheld under this section. If necessary, the corporation shall obtain such funds from the shareholders.

(i) If a corporation fails to withhold and pay any amount of tax required to be withheld under this section and thereafter the tax is paid by the shareholders, such amount of tax as paid by the shareholders shall not be collected from the corporation but it shall not be relieved from liability for interest or penalty otherwise due in respect to such failure to withhold under IC 6-8.1-10.

(j) A corporation described in subsection (a) may file a composite adjusted

> gross income tax return on behalf of some or all nonresident shareholders if it complies with the requirements prescribed by the department for filing a composite return. (**Emphasis added**).

In this case, the Taxpayer filed the composite IT-20 COMP withholding return which met all of the Department's requirements for the nonresident shareholders. Therefore, it complied with the law and the penalty should not have been imposed.

FINDING

The Taxpayer's protest is sustained.

KMA/LS/DK – January 8, 2008